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Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World

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Introduction

In post-Soviet Russia, American law professors wrote the new corporate code at Yeltsin's request. When the socialist block disintegrated, the Word Bank's top priority was "drafting and quickly adopting new laws and regulations required to build a market economy."[1] And in Korea during the Asian financial crisis, while the government was urging housewives to donate their gold jewelry to avert budgetary meltdown, it was negotiating a rescue package with the IMF conditioned on a massive overhaul of the country's corporate, bankruptcy, and securities laws.[2]

The applications are new, but the idea that law is essential to economic development—and the quest to understand the precise relationship between legal systems and markets—is old. In late nineteenth century Germany, Max Weber used law to explain the rise of capitalism in Western Europe. Weber famously asserted that "rational"[3] law supports economic activity by lending predictability and legitimacy to the rules of market exchange. In the twentieth century, Hayek asserted that the common law, reflecting a tradition of constraint against governmental authority, is better suited to a market economy than the civil law. As the twenty-first century approached, prominent economists produced a line of provocative empirical research whose critical explanatory variable was the "origin" of a country's legal system.[4] The work linked differences in

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[1] World Bank website, Europe and Central Asia Judical Reform, General Overview, available at http://www.worldbank.org.

[2] Assif Shameen, Dream and Controversy, Asiaweek.com, available at http://www.parthfinder.com/asiaweek/99/0625/biz4.html; Financial Crisis in Korea (Jan. 19, 1998), available at http://www.dwnam.pe.kr/021%20imf-980119.html.

[3] For Weber, rationality of law stemmed from its autonomous, universal and consciously constructed character.

[4] We will discuss this literature extensively in Chapter 2 below.

economic structures such as patterns of share ownership and the size of stock markets to the quality of shareholder protections provided by national legal systems. Common law systems were found to provide higher quality protections than civil law—particularly French civil law—systems, resulting in more dispersed share ownership and larger stock markets. Extending the implications of this research in the early 2000s, scholars found evidence that in recent history, countries with common law systems have experienced faster economic growth than those belonging to the civil law family.

Bringing this long line of important research into sharp focus in the past few years are two real-world developments at the center of this book. The first is a series of high-profile corporate crises around the world. Starting with the Enron debacle in the United States, major economies have witnessed extraordinary corporate governance controversies in the past five years that have shaken confidence—not only in the stock market, but in the very institutional foundations of market activity in these countries. Each crisis has, in its own way, challenged the adequacy of the country's legal system, and prompted institutional responses to repair the perceived shortcomings. The second development is globalization. While the fact of economic globalization is well known, its implications for domestic legal systems have not been thoroughly examined (at least in scholarship concerned with corporate governance) outside the confines of the rather impoverished "convergence" debate.[5] Combining the two developments, many countries facing serious institutional challenges as a result of corporate governance crises or

[5] See infra Chapter 11. There is, however, an extensive literature on the existence of transnational networks among national regulators, courts, and lawmakers, and its effect on the making and enforcement of law globally. For a recent review of this literature, see (Slaughter 2004).

broader macro-economic problems[6] have over the past 15 years turned, either voluntarily or under pressure from international organizations such as the World Bank, to a fairly standard menu of legal reforms. The components of this menu, drawn predominantly from the U.S. legal system, were influenced by the recent economics scholarship linking favorable economic outcomes to "good" law. Not implausibly, since common law regimes score well in this research, for many scholars and policy makers, "good" is equated with Anglo-American (typically U.S.) law.

So we have arrived at a fascinating moment. Economists have provided us with some important empirical results on the relationship between legal institutions and economic outcomes that echo theories advanced by past generations of major thinkers. Simultaneously, the importance of creating effective legal systems for market activity has been underscored by a host of recent events, such as the transformation of the former Eastern block regimes, the Asian financial crisis, and a series of corporate governance scandals around the world. The policy response, applied liberally from Seoul to Warsaw, is to recreate features of the U.S. legal system thought to account in some way for the comparative robustness of U.S. economic institutions.

But does the prevailing view of the relationship between law and capitalism hold up under sustained scrutiny? Does law support market activity only in the ways generations of scholars have assumed? Why have some of the most dramatic economic success stories in history—China is only the latest example—occurred in the absence of a "rule of law" as that term is commonly understood in Western economics and legal

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[6] In some cases, it can be difficult to disentangle corporate governance problems from macro-economic problems. For example, observers disagree about the precise origins of the Asian Financial Crisis that afflicted South Korea and other countries in 1997-98. Some emphasize weak corporate governance and legal institutions, while others fault exchange rate and interest rate policies and related macro-economic trends.

scholarship? Can an effective legal system for economic growth be imported, as decades of World Bank-instituted institutional reforms have assumed? Does globalization imply convergence on an efficient model of legal governance for economic activity? Are legal harmonization efforts such as those in the EU an effective short cut to the creation of effective legal regimes?

We don't claim to have definitive answers to all of these big questions, of course. (We may be foolhardy for writing a book on such a huge topic, but we are also sensitive to the limitations of our analysis, a point we explicitly address below.) What we do have, however, is a perspective on the relationship between law and capitalism that generates answers quite different from the ones taken for granted in the economics literature and the policy world.

Before summarizing our analytical perspective and its implications, we pause to define a few key terms. The *law* in our title—and the focus of our analysis—is law supplied by the sovereign. In other words, law promulgated by legislatures, government agencies or courts, and enforced by agents of the state. We often use the term "formal law" to distinguish this type of authority from informal governance mechanisms such as social norms, rules promulgated by organizations, and codes of best practice. However, we do not limit *law* to the sum of legal rules or standards found in statutes and case law. Instead, the focus of our analysis is the formal legal system, including the processes by which formal law is made, contested, and ultimately implemented and enforced. Capitalism for our purposes is market-oriented economic activity in a system of declining state control of productive assets. Market-oriented systems are typically associated with private ownership of the means of production, but as is well known, market economies

are compatible with extensive state ownership or hybrid ownership patterns. We discuss China and Russia extensively in this book, with the full knowledge that these economies are not completely capitalist in their orientation. Sometimes observers make the same claim as to Japan and Germany—two other countries we examine in depth—though the argument is more rhetorical as applied to them. Nonetheless, it raises an important point that should be made at the outset: just as there are varieties of capitalism,[7] there are varieties of legal support for capitalist activity. China and Russia are particularly interesting to us precisely *because* their economies are unevenly evolving toward, rather than fully possessed of, market institutions in a system of private ownership. The ongoing experience of these countries provides the opportunity to analyze the role of law in facilitating the movement toward markets, and the obstacles to this trajectory.

As explained more fully below, the empirical core of the book is comprised of six analytical narratives of recent corporate governance scandals or controversies around the world. *Corporate governance* is shorthand for the complex system by which firms are structured, financed, and controlled. Our own backgrounds as scholars of comparative corporate law undoubtedly account in part for the book's emphasis on corporate governance. But there are several powerful reasons to focus on corporate governance as a vehicle for better understanding the relationship between legal and economic institutions. First, firms are the most important private actors in a market economy. A successful capitalist economy without successful firms is inconceivable. Thus, the legal underpinnings of firm-level governance, as well as the legal responses to firm-level crises, warrant close analysis. Second and even more importantly, as we have learned from experience throughout the world over the past decade, corporate governance is linked to

[7] See infra Chapter 2.

every facet of a country's economic, political and legal structures. Many of the rules by which firms operate are supplied by the state ("formal law" to use our terminology), but ownership structures, managerial priorities, and relationships with other market actors are also deeply embedded in the political, social and economic infrastructure. An extended inquiry into corporate governance thus requires venturing deeply into the institutional structure of the entire economy. We therefore use corporate governance as a lens through which to view a much larger set of institutional phenomena in a given country and to analyze, as rigorously as possible, the relationship between the legal system and that portion of the economic system directly related to firm structures and governance.

Our Analytical Framework

In the prevailing view, law fosters economic activity (exclusively) by protecting property rights. A legal system which clearly allocates and protects property rights (a "rule of law") precedes economic development and is a precondition to economic success. Once such a system is in place, it constitutes a fixed and politically neutral institutional endowment—an unchanging foundation for economic activity. The formal characteristics of legal systems--in particular, their association with either the common law or the civil law families--determine how well they provide property rights (particularly investors' rights) protections. The quality of property rights protections, in turn, determines economic outcomes.

We refer to this view, perhaps somewhat unfairly, as "Weber's legacy"[8] because like Weber, the modern policy makers and economics researchers are attracted to a

[8] Weber did not see a firm link between English common law and economic development. (see quote from Friedman at 22, fn 43).

formalistic and deterministic view of the relationship between law and markets. Law drives economic activity; the higher the "quality" of the legal rules, the better the economic outcomes. We don't mean to downplay the contributions of this literature. It has provided some fascinating empirical results that provoked an intense and ongoing dialogue between economists and legal scholars. But we believe the conceptual apparatus widely in use today does not provide very powerful tools for unpacking the important questions we posed earlier. In our more cynical moments, we caricature the canonical view that has taken hold in the economics literature and policy world with the following simple equation:

Good Law + Good Enforcement = Good Economic Outcomes

It is easy to understand why so many economists and World Bank reformers have been attracted to a simple view of law's relationship to a liberal market economy. It is clean and straightforward. It depicts law as a kind of technology that can be inserted in the proper places--and imported from abroad when necessary--to accomplish an important task. And the canonical view rests on the hoariest of conventional wisdoms--that a rule of law is an essential prerequisite to economic growth and political liberalization.[9] As one scholar puts it, the "fullest achievement [of the rule of law ideal] is associated with the maturation of capitalism into laissez-faire competition under conditions of political stability."[10]

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[9] We do not wish to delve deeply into the voluminous literature on the definition of the rule of law and the various ends to which scholars have used the term. In the policy world and academic literature most closely related to our topic, the rule of law signifies an infrastructure of generally applicable legal rules that lend predictability to economic behavior and constrain discretionary governmental intervention in the economy. Ohnesorg (2003) discusses at length the definition of the rule of law in the law and development literature.

[10] (Hong 1999), at p. 147.

This view of the relationship between law and capitalism, however, rests on a number of assumptions that do not bear up to careful scrutiny, as we will explain in Chapters 2 and 3. Nor does it explain some of the most important economic success stories of the twentieth century, such as Japan, Korea, and most recently, China. Unfortunately, "good" or "high quality" law (whatever that means, exactly) and "good" enforcement (ditto) do not lead inexorably to good economic outcomes. On the other hand, many countries have achieved remarkable economic growth with legal systems that don't live up to the canonical rule of law ideal.

Our book is an attempt to provide a new perspective on *how* law supports markets. The starting point for this effort is the recognition that law is not an endowment like a fixed capital investment which, once in place, provides a firm foundation for capitalist activity.[11] The vibrancy of a capitalist system hinges on creative destruction in the governance sphere as well as the economic sphere. Governance structures of all types, including law, must adapt and respond to changes in the economy. Rather than thinking of a legal system as a fixed endowment for the economy, it is more productive to view the relationship between law and markets as a highly iterative process of action and strategic reaction. We call this a *rolling relationship* between law and markets.[12] This is not to say that the relationship is smooth, effortless or necessarily efficiency enhancing. Indeed, we will see that it is often edgy and unpredictable. The first point is simply that law and markets react to one another with human agents and institutional mechanisms mediating between the two. Viewing the relationship as dynamic rather than fixed is

[11] For a critical perspective on this Weberian legacy, see also (Sabel 2005).
[12] (Dorf and Sabel 1998). As discussed in Chapter 3, we use the term in a somewhat broader sense than prior scholars.

important because it shifts the focus of inquiry from the "origin" of legal systems to how they change and where they are heading.

A second basic recognition motivating our analysis is that not all legal systems—not even all legal systems associated with successful economic development—are organized similarly or perform identical functions in support of economic activity. In other words, there is no single "rule of law" that maps onto real world economic success. We will see that, as a historical matter, different types of legal system are conducive to economic success. Each has its own costs, benefits and vulnerabilities. Here, we are not referring to the canonical taxonomy between common law and civil law systems, which looms so large in the literature. We find this distinction to be unhelpful for analytical purposes. Rather, legal systems can be distinguished on the basis of several factors that have not received sufficient attention in the literature,[13] including (1) the organization of the legal system, (2) the functions law plays in support of market activity, and (3) the political economy for law production and enforcement.

(1) *Organization of the legal system*: Legal systems can be more or less centralized in relation to the lawmaking and enforcement processes. Centralized systems typically vest lawmaking powers in the legislative and/or the executive branch and prefer centralized law enforcement mechanisms of the state over decentralized law enforcement tools such as courts and private litigation. Decentralized systems allocate lawmaking and law enforcement activities to multiple agents, including private parties who may exercise extensive rights to initiate law enforcement and to participate in lawmaking processes. Decentralized systems appear to be more adaptive than centralized systems, but they are

[13] As discussed in Chapter 2, the notion that governance mechanisms may be more or less centralized as such is not new, but the extent to which this is reflected in the organization of legal systems has not been consistently explored.

far more complex, posing challenges in terms of predictability and the capacity to engineer broader social change. By contrast, centralized systems appear to have greater organizational capacity, but may be less responsive to particularized demand for change.

(2) *The functions attributed to law:* Law can perform multiple functions in support of market-oriented economic activity. The clear allocation and protection of property rights, which is the exclusive focus of existing literature, is only one possible function of law. In some legal systems this "protective" function of law is indeed dominant.[14] But in other legal systems, residual rights of control are allocated to multiple agents, encouraging or even forcing them to bargain over outcomes within the boundaries established by law. In these systems the "coordinating" function of law dominates. Supplemental to these two basic functions of law are signaling and credibility enhancement. Law can provide important signals to market actors, inducing behavioral change, even if the signals are not universally backed by legal enforcement. Law can also be used to lend credibility to government policies, enhancing their effectiveness as governance mechanisms. The signaling and credibility enhancing functions of law are equally prevalent in systems where the protective or coordinating functions of law dominate. We therefore focus primarily on the differences between the protective and coordinating functions. In each real world system, the protective and coordinating functions of law coexist and may be balanced differently in different areas of the law. However, the dominance of one or the other function distinguishes legal systems. There is clearly an affinity between the organization of legal systems and the functions it performs. Centralized systems tend to be coordinating, whereas decentralized systems

[14] Note that we do not claim that the legal system is actually capable of a complete and clear allocation of rights. Instead, we are referring to the aspirations of legal systems as reflected in substantive law and in the legal mechanisms available for rights enforcement.

tend to engender a protective function of law. Which of these two functions dominates depends on the existence and character of a host of institutions and organizations such as courts, lawyers, law enforcement agencies, labor unions, and business groups that either precede the introduction of formal law or co-evolve with formal law. Once an entire system supporting a particular function of law is in place, it is difficult (but not impossible) to change. As our case studies will demonstrate, under the 'right' external circumstances, change capable of altering the organization and dominant function of a legal system does occur.

(3) *Political economy*: Law, a product of human interaction, obviously does not function independently of the political system. Yet the prevailing view implicitly assumes that legal systems conducive to economic activity are politically neutral endowments. Others have noted, of course, that law changes through the political process. But the political economy is crucial to the formation and change of legal systems in a way that has not been developed in the literature: the political economy determines whether law is *contestable.* As we use the term, contestability is a measure of the extent to which law is subject to a process of creative destruction, particularly through the participation of actors across the spectrum, including private, social, as well as government actors as opposed to being an instrument exclusively in the hands of uncontested political authorities. Contestation of law may occur in both centralized and decentralized legal systems. However, the identity of the players participating in the contestation of law and their interests is likely to differ. A highly centralized legal system favors state-vetted interest groups and actors. A decentralized legal system favors self-organized groups and individuals.

A final basic recognition is that law is not the only mechanism governing economic activity in capitalist systems, and in some successful economies it is not even the primary governance mechanism. Any deep understanding of the relationship between law and capitalism must therefore not only account for the "supply" of formal law, which has been the exclusive focus of analysis, but also the *demand* for law, which can change over time and with changes in the constituencies who participate in market activity. The demand for law – and the ability to voice that demand - is significantly affected by the organization and functions of the legal system in a given country which we have just described. Moreover, demand for law will vary from country to country, depending on the political economy and the nature of the market. Demand for law increases with changes in the socioeconomic conditions of those who have access to the production of law, with the creations of new market transactions for which non-legal governance mechanisms are inadequate, with the introduction of new market entrants who lack access to alternative governance mechanisms, and with the failure of existing mechanisms to provide effective governance or to respond effectively to changes in the economic or political sphere.

The organization of legal systems, the functions they perform and their relation to the political economy, as well as the demand for law have important implications for any theory of legal change. Explaining legal change (that is to say, how legal systems change as opposed to changes in specific legal rules)—something else the existing literature is not very good at--is crucial because, as we will see, legal change is a feature common to each of the diverse countries we study in this book. We will show that our analytical framework provides a useful way to think about legal change around the world.

Applying the Analytical Framework: Institutional Autopsies

Thus far, we have sketched our framework of analysis in rather abstract terms. In order to put flesh on the framework, we apply it in an approach we call the "institutional autopsy." This entails close examination of a firm-level crisis, problem, or controversial corporate governance event. As noted above, corporate governance is a window into the larger and more complex system of economic governance. By carefully examining an extraordinary firm-level event and the response it generated among key actors, we believe it is possible to gain a much deeper understanding of how the entire system is structured, its strengths and weaknesses, and the likely direction of future institutional developments. Notwithstanding the aura of demise surrounding the term, we think "autopsy"--particularly in the medical school sense--captures the essence of our methodology: the systematic analysis of a complex system to reveal its inner logic, weaknesses, and prospects for reform. (If readers prefer an engineering metaphor, our case studies examine "stress tests" of the various systems under investigation in the book.) In each case, our goal is to use the single-firm event as a springboard to understanding the role of law in corporate governance and economic growth in each country, and try to provide an intellectual roadmap for thinking about future reforms of each of the systems.

In the book, we perform institutional autopsies on six recent corporate controversies from around the world. We begin with the Enron debacle and focus our attention on how the U.S. legal system—which in many respects is an outlier in its decentralized, protective, and contestable features—both contributed and responded to

the crisis. Next, we turn to the Mannesmann executive compensation scandal and criminal trial in Germany, the paradigmatic centralized and coordinative legal system, and its struggle to accommodate non-traditional business practices. We then examine Japan's institutional response to the rise of hostile takeovers, another example of a centralized, coordinative legal system confronting new challenges. Next, we examine the role of law in a foreign institutional investor's challenge to one of the Korean chaebol, or business groups. Then we turn to two economies making a fitful transition to capitalism, China and Russia. For China, we use an insider trading and false disclosure scandal at a state-owned firm listed in Singapore to analyze the challenges to legal governance in China and to suggest how an apparent conflict between informal coordination and formal rights enforcement can be resolved in a manner that merges these two alternative modes of governance. The case also gives us occasion to reflect on the operation of the Singaporean governance system and speculate whether it might hold lessons for China. Finally, we examine the use of law in the hands of President Putin to "re-nationalize" Yukos, a major player in Russia's energy market.

In each case, we show how our analytical framework helps understand the deeper significance of these controversies. We situate the controversy within a much broader (if necessarily succinct) examination of each country's historical use of law to govern market activity, expose the key challenges to legal governance they face, and provide an intellectual roadmap for understanding future legal change in light of those challenges.

Caveat

A few words about what we are *not* trying to do with this methodology. Contemporary academic and policy research on this topic are replete with rankings and indices—rule of law rankings, investor protection indices, and so on. These objective measures have proved provocative and useful in many ways. But they also have serious limitations which are often ignored by succeeding waves of scholarship and policy advice. The institutional autopsies in this book are not intended to serve as the basis for ranking the countries under study or for side-by-side comparisons of the "quality," "effectiveness" or "efficiency" of their legal institutions (to cite some of the more common adjectives in use today). Indeed, the tendency to place great analytical weight on quantifiable but extremely thin legal variables is one source of our dissatisfaction with the existing literature. Our focus is positive (descriptive), not normative. We have tried to provide thick, theoretically informed descriptions of the separate systems—to understand each on its own terms rather than by reference to an ideal type or another system. Indeed, one of the central messages of the book is that law does not function similarly in every successful economy. Each of the countries we discuss faces its own legal governance challenges going forward, with its own preexisting institutional inclinations to both guide and hinder that process. We make comparisons among the countries wherever such comparisons present fertile analytical ground. But we do so to explore the institutional choices a country has made in the past or that may be open to it in the future, not to keep score.

Limitations of our Methodology

All methodologies have their limitations, and we want to address the limitations of ours up front. The cases featured in our institutional autopsies were not selected from a random sample of comparable firm-level events around the world. We could have selected different cases, different countries, or different time periods as the focus of our study. It is possible that our case selection affected our inferences and conclusions. As noted above, however, we had many reasons for picking these cases. Perhaps most importantly, each of the events we highlight was deemed sufficiently important that people working within those systems reconsidered its operation in light of the new information revealed by the event.

Another possible weakness in our methodology is that we focus on extraordinary events. Extraordinary events may mislead if the objective is to understand the ordinary operation of a system. But we believe that out-of-equilibrium events are often very revealing, because they expose features and weaknesses of a system that fell beneath the radar when it was functioning smoothly. To use a metaphor suggested to us by Mel Eisenberg, an autopsy reveals more information than an annual checkup. A separate justification for focusing on problematic or controversial events is that, for better or worse, big events have always been important catalysts for lawmaking throughout history. Think of the legal responses to the South Sea Bubble in late 18th century England,[15] the Depression's role in the creation of the Federal securities laws in the United States, the impact of the 1997-98 Asian financial crisis on the Korean legal system, or the Enron scandal's role in catalyzing passage of the controversial Sarbanes-Oxley Act in the

[15] See Banner (1998).

United States. We'll have much more to say about the latter two events and their impact on legal change later in the book.

An institutional autopsy can be interesting and informative in its own right – and may even have entertaining value. Our goal, however, is to learn from the autopsies about a system, i.e. to generalize from a firm level breakdown to the operation of a governance system. We have taken care to select the cases so that they reveal system-specific vulnerabilities. We therefore place each case into the broader governance context in which it occurred with the help of secondary literature that has identified key characteristics of these governance systems.

A final limitation stems from the definition of "law" we have adopted for this book--state-created (or "formal") law. This is obviously a top-down approach to understanding the relationship between law and markets. An alterative, bottom up approach would examine the organizing principles shaping market activity and the enforcement actions of the relevant community. We could have examined the grass roots formation of informal norms, practices and organizational codes that support market exchange in the absence or in support of formal law. Weber himself was careful to define law in such a way that it included both rules created and enforced by agents of the sovereign, as well as rules created and enforced by other groups, such as the Church, gangs, merchants, and so on.[16] Similarly, Hayek believed that law—in the sense of an accepted set of basic norms that govern society--precedes legislation. There is no

[16] Characteristically, Weber defined law not by reference to some commonly accepted usage of the term, but according to his own conceptual framework. Weber believed that social conduct has validity to the extent that it complies with legitimate order. He calls that order "law" when violation will likely be met with coercion of some kind exercised by a group of people who stand ready to perform that role. This conceptual framework studiously avoids exclusive reference to state-created law enforced by agents of the sovereign (Rheinstein 1954): lxiii.

question that informal rules of this type are absolutely crucial to economic activity. In fact, informal rules and non-legal governance mechanisms feature prominently in our analysis. The focus on formal law defines our entry point for the analysis of a particular governance system. By analyzing the relevance – or irrelevance - of formal law we learn a great deal about the availability and efficacy of alternative governance mechanisms. Focusing on formal law is an attempt to more clearly define the scope of analysis – not a normative pre-conception about the merits of legal versus non-legal forms of governance.

Outline of the Book

Part I sets the stage for our analysis. In Chapter 2, we sketch the building blocks of the prevailing view of the relationship between law and markets in the literature from Weber to the present, and show how academic research has shaped legal reform efforts around the world over the past decade. We expose the assumptions underlying the prevailing view and raise some real-world facts that are inconsistent with its basic premises. Chapter 3 is the analytical heart of the book. In place of the prevailing view, in this chapter we develop a dynamic conception of legal and market development emphasizing different functions played by law in support of markets, the importance of analyzing the demand for law and the process of legal development, and adaptation of law to the needs of marketplace.

Part II of the book applies the analytical framework in six institutional autopsies: The Enron scandal and ensuing legal reforms in the United States (Chapter 4), the executive compensation trial over severance payments in connection with the Mannesmann takeover in Germany (Chapter 5), the hostile takeover attempt by Livedoor

and contemporaneous adoption of guidelines on takeover defenses in Japan (Chapter 6), the scandal at the SK group and insurgency by a foreign institutional investor in Korea (Chapter 7), the China Aviation Oil crisis and ensuing resolution of the problem in China and Singapore (Chapter 8), and the struggle for control over natural resources in Russia illustrated by the Yukos episode (Chapter 9).

Part III extends the analysis by exploring the implications of the institutional autopsies. In Chapter 10, we move beyond system-specific analysis to compare the functions and centralization of lawmaking across countries. Because the autopsies reveal legal change to be a feature common to all the systems we analyze, Chapter 11 examines the process of legal change and its implications for foreign legal transplants, convergence and legal harmonization. We end the book in Chapter 12 by stating our key conclusions and raising several fertile areas for future research.

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Our goal in this book is to deepen understanding of law's role in the economy—over time and across countries. Along the way, we hope to deepen our understanding what "globalization" means for domestic legal development today. We bring to this inquiry a lawyer's attention to institutional detail, and (we believe) a sophisticated sense of how law actually operates in the world, as opposed to the role it plays in theoretical models and regression analyses. We have no quarrel with theory or empirical research—we use both extensively to inform our analysis. But many commentators on this important question, particularly many economists, fail to treat law for what it is—the product of human interaction—and fail to perceive the functions that legal institutions

actually play in support of markets, the perpetual, if uneven and unpredictable, process by which those institutions are formed and reformed, and the ways in which every society—from the most to the least highly developed in economic terms—supplies substitutes for legal institutions so that markets can function and economic organizations can be formed.

Alas, the relationship between law and capitalism, like many things in life, is far more complex than one would hope for in an ideal world. But in the complexity lie discernable patterns, the perception of which promises to change the way we understand a subject that has—with good reason—preoccupied generations of scholars. We devote the remainder of the book to unpacking that complexity and exploring the implications of those patterns.